STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: INTERSTATE POWER AND LIGHT COMPANY	DOCKET NO. RPU-02-6

ORDER APPROVING SETTLEMENT AND GRANTING APPLICATION

(Issued September 17, 2002)

INTRODUCTION AND PROCEDURAL HISTORY

On June 10, 2002, Interstate Power and Light Company (IPL) filed with the Utilities Board (Board) an application for determination of ratemaking principles for the Power Iowa Energy Center (PIEC), a 632.4 MW nameplate capacity combined-cycle generating unit IPL plans to build in Cerro Gordo County, Iowa. IPL intends to place the facility in service in June 2004.

This is the second such proceeding, which is pursuant to Iowa Code § 476.53 (Supp. 2001). Section 476.53 was enacted during the 2001 legislative session as part of House File 577. This section provides that when defined new electric generation is constructed by a rate-regulated public utility, the Board, upon request, shall specify in advance, by order issued after a contested case proceeding, the ratemaking principles that will apply when the costs of the new facility are included in electric rates. Section 476.53(1) states that the General Assembly's intent in enacting the legislation is to "attract the development of electric power generating and transmission facilities within the state . . ."

The ratemaking principles proceeding is only available to rate-regulated public utilities that build or lease certain defined generation. The statute does not apply to purchase power contracts, meaning that a rate-regulated public utility that purchases electricity from another provider, such as an independent power producer, cannot receive advance ratemaking treatment for that purchase. Other electric utilities, such as municipals and cooperatives, do not need a statute such as section 476.53 to encourage them to build new generation. Those utilities can recover costs of a new plant in any manner approved by their boards or councils, because the Board does not regulate their rates. The proceeding may be used for the following facilities constructed or leased in Iowa:

1. a base load unit with a nameplate capacity of 300 MW or greater; or

2. a combined-cycle facility; or

3. an alternate energy production facility as defined in section 476.42.

The proposed IPL facility qualifies for ratemaking principles as a combined-cycle facility and no party disputed that section 476.53 applies to the PIEC.

In addition to the Consumer Advocate Division of the Department of Justice (Consumer Advocate), the Iowa Consumers Coalition (ICC) and CPV Highlands, L.L.C. (CPV), intervened in the ratemaking principles proceeding. IPL submitted prefiled testimony. Prior to the date for filing intervenor testimony, Consumer

Advocate and IPL filed a motion to suspend the procedural schedule. The Board suspended the schedule by order issued August 29, 2002.

IPL and Consumer Advocate filed a proposed settlement of all outstanding issues on August 29, 2002. In the settlement and accompanying motion to approve settlement, IPL and Consumer Advocate said they were authorized by the ICC to state that the ICC does not object to the settlement. IPL and Consumer Advocate further said they were authorized by CPV to state that CPV does not take a position regarding the settlement and waives its right to a settlement conference pursuant to 199 IAC 7.2(11)"b."

Although Iowa Code § 476.53(3)"d" allows the ratemaking principles proceeding to be combined with a proceeding for issuance of a generation certificate under Iowa Code chapter 476A, the two proceedings were not combined here and the settlement only addresses the ratemaking principles proceeding. IPL's application for a generating certificate was the subject of a separate docket, Docket No. GCU-02-2. The Board granted the certificate, subject to IPL obtaining final pre-construction permits and filing a transmission study, by order issued September 13, 2002.

IMPACT OF RATEMAKING PRINCIPLES DECISION AND THE BOARD'S SETTLEMENT RULES

As the Board discussed in its first ratemaking principles order, the decision of the Board in a regulatory principles proceeding has more long-term impact than perhaps any other type of decision. MidAmerican Energy Company, "Order," Docket

No. RPU-01-9 (5/29/02), pp. 3-4. A key aspect of section 476.53 is that the ratemaking principles established in this proceeding shall be binding with regard to the specific electric power generating facility in any subsequent rate proceeding. (Emphasis added). In other words, if the decision is not a reasonable one, it cannot be undone in a subsequent rate case. The Board in that order also discussed the interplay between the ratemaking principles statute and Iowa Code chapter 476A, the generation siting chapter. Id. at pp. 4-6.

While the discussion will not be repeated to here, it is important to emphasize that while the intent of section 476.53 is to encourage Iowa-built generation by rate-regulated utilities, the legislative intent is not that this generation be built at any cost. Requested principles must be balanced with the impact on the utility's ratepayers.

Subrule 199 IAC 7.2(11) provides, in part, that the Board shall not approve settlements "unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest." This standard applies whether or not any party contests the proposed settlement. In evaluating the public interest, the Board, among other things, must balance the interests of the utility and its ratepayers.

CONDITIONS PRECEDENT

Iowa Code § 476.53(3)"c" provides that before determining applicable ratemaking principles, the Board must make two findings. These findings are conditions precedent to a determination of ratemaking principles, because if the Board cannot make these findings, the utility cannot receive ratemaking principles.

First, the Board must determine that the public utility has in effect a Board-approved energy efficiency plan. Second, the utility must demonstrate that it has considered other sources for long-term supply and that the facility is reasonable when compared to other feasible alternative sources of supply.

The settlement stipulates that IPL has met both of these conditions. The Board has examined the record and there is no evidence to the contrary. The Board finds that IPL has satisfied the conditions precedent contained in Iowa Code § 476.53(3)"c."

SUMMARY OF SETTLEMENT

The settlement provides for four ratemaking principles. These deal with the return on equity, depreciable life, mitigating regulatory lag, and project cancellation costs.

IPL and Consumer Advocate agreed to a return on common stock equity of 12.23 percent for the life of the PIEC. IPL had requested 13 percent. The settlement provides that the depreciable life of the PIEC for ratemaking purposes is 27.6 years. IPL, in its initial filing, requested a plant life of not less than 25 years.

In its filing, IPL sought to mitigate regulatory lag by application of the following ratemaking principle: the capital and operating costs associated with the plant (with the exception of fuel costs) shall be deferred in a regulatory asset account until it is recoverable in base rates. Rate recovery of the deferred costs shall be over the same length of time in which the costs were incurred and the amount of deferral shall be offset by the amount of purchased power capacity costs the plant displaces. The

proposed settlement provides that IPL's prudently incurred annualized net investment in the PIEC shall be included in rate base and IPL's prudently incurred annualized depreciation expenses, non-fuel related operations and maintenance costs, property and miscellaneous taxes shall be included in operating expenses used to calculate the revenue requirement when determining IPL's first interim rates and first final rates which become effective after the date the PIEC is placed in service, provided however, that the prudence of the costs may be disputed by any party and shall be subject to determination by the Board.

The final ratemaking principle contained in the settlement is that if IPL cancels the construction of the PIEC for good cause, IPL's prudently incurred costs shall be amortized over a period not exceeding five years commencing not later than six months after the cancellation. The annual amortization shall be included in the calculation of IPL's revenue requirement but the unamortized balance shall not be included in rate base in any determination of interim and final rates thereafter during the period of amortization, provided however, that the prudence of the costs and the good cause for cancellation may be disputed by any party and shall be subject to determination by the Board. In its initial filing, IPL requested that it be allowed to recover all prudently incurred and committed costs of the proposed facility in the event the project is cancelled for good cause, with the recovery period not exceeding five years.

On the same date the proposed settlement was filed, IPL filed an application for authority pursuant to Iowa Code § 476.6(10) to file a new electric rate case in the

first half of 2003. This section prohibits a utility from filing a new rate case for which a rate case is pending within 12 months following the date the prior case was filed or until the Board has issued a final order on the prior case, whichever is earlier, without Board authority to make the subsequent filing at an earlier date. The proposed settlement provides that it shall not be effective unless the Board grants IPL's application.

DISCUSSION OF SETTLEMENT

1. Depreciable Life

IPL initially requested a depreciable life of not less than 25 years. The proposed settlement provides that "the depreciable life shall be fixed for the life of the PIEC for ratemaking purposes and shall be 27.6 years." This number is reasonable and is identical to the depreciable life approved by the Board in the first ratemaking principles order case, which involved a similar generating facility. As the Board noted in that order, combined-cycle technology is too new for precise figures on known useful or depreciable life to be available. MidAmerican Energy Company, "Order," Docket No. RPU-01-9 (5/29/02), pp. 8-9. The 27.6 year figure is within the range of reasonableness based on the surveys of depreciable lives used by IPL in this case and MidAmerican Energy Company (MidAmerican) in Docket No. RPU-01-9.

2. Mitigation of Regulatory Lag

The principle regarding regulatory lag agreed to in the settlement is generally consistent with traditional ratemaking principles. It provides that IPL's prudently incurred annualized net investment in the PIEC shall be included in rate base and

IPL's prudently incurred annualized depreciation expenses, non-fuel related operations and maintenance costs, property and miscellaneous taxes shall be included in operating expenses to calculate the revenue requirement when determining IPL's first interim rates and first final rates which become effective after the date the PIEC is placed in service, provided however, that the prudence of the costs may be disputed by any party and shall be subject to determination by the Board.

This principle is consistent with past precedent. In Docket No. RPU-83-24, the Board allowed Iowa Power and Light Company, a predecessor to MidAmerican, to implement interim or temporary rates at levels that included costs related to commercial operation of the Louisa Generating Station. Iowa Power and Light Company, Docket No. RPU-83-24, "Order Setting Interim Rate Level and Approving Corporate Undertaking," (9/8/83 and 10/14/83). Also, the utility was allowed to increase these temporary rates immediately upon the Louisa facility being placed into service.

It is important to note that under the principle contained in the settlement, cost levels will be subject to normal prudency reviews. If some costs are determined to be imprudent, they could be disallowed. The principle contained in the settlement is reasonable.

3. Project Cancellation Costs

The proposed settlement provides that if IPL cancels the construction of the PIEC for good cause, IPL's prudently incurred costs shall be amortized over a period

not exceeding five years commencing not later than six months after the cancellation. The settlement further provides that the annual amortization shall be included in the calculation of IPL's revenue requirement, but the unamortized balance shall not be included in rate base in any determination of interim and final rates thereafter during the period of amortization, provided however, that the prudence of the costs and the good cause for cancellation may be disputed by any party and shall be subject to determination by the Board.

The Board finds this principle to be reasonable. Because of the value of adding the PIEC to IPL's generation mix in Iowa, the Board believes the risk of cancellation is small. In any event, the principle provides that the Board will determine the prudence of any costs incurred and whether good cause existed for the cancellation.

4. Return on Equity

The proposed settlement provides that the rate of return on common equity shall be fixed for the life of the PIEC and shall be 12.23 percent. IPL had initially requested 13 percent.

The Board's risk premium approach, which adds 250 to 450 basis points to the most current A-rated utility bond published yield (Mergent Bond Record, August 2002), produces a cost of equity range between 10.10 and 12.10 percent. While the settlement provides for a rate slightly above this range, it should be noted that yields are at levels not seen for many years. The 12.23 percent rate is identical to the rate determined by the Board to be appropriate in the first ratemaking principles

proceeding, which involved a similar generating facility. MidAmerican Energy Company, "Order," Docket No. RPU-01-7 (5/29/02).

The Board in the MidAmerican case noted that the Board "will continue to compare the risks the utility is willing to undertake with the principles it is requesting, and attempt to strike a fair balance between risk and reward." Id., p. 26. In this case, IPL is retaining some of the risk which MidAmerican did not, because the MidAmerican decision guaranteed that a certain level of plant costs would be included in rate base and exempt from further Board review. The increased risk undertaken by IPL and the historically low bond yields justify the Board finding that the 12.23 percent return on equity agreed upon in the settlement is reasonable.

5. Application for Authority Pursuant to Section 476.6(10)

The settlement provides that it shall not become effective unless and until the Board, pursuant to Iowa Code § 476.6(10), grants IPL's application requesting authority to file an electric rate case in the first half of calendar year 2003. Section 476.6(10) prohibits a utility from filing a new rate case for which a rate case is pending within 12 months following the date the prior case was filed or until the Board has issued a final order in the prior case, whichever is earlier, without Board authority to make the subsequent filing at an earlier date.

IPL has two electric rate case dockets pending, Docket Nos. RPU-02-3 and RPU-02-8. The two dockets have been consolidated. While the Board has said it intends to issue a final order in the consolidated dockets by April 15, 2003, the statutory ten-month deadline in Docket No. RPU-02-8 extends until the latter part of

May 2003. If the Board does not grant IPL's application, it could not file another electric rate case in early 2003.

IPL states that granting its application is necessary to carry out the terms of the settlement. The ratemaking principle contained in the settlement allows IPL to mitigate regulatory lag by recovering costs in rate base as soon as the plant is placed in service. In fact, costs of the plant can be recovered in temporary rates consistent with the principles established in Docket No. RPU-83-24, Iowa Power and Light Company. However, even though the PIEC is not scheduled to be completed until June 2004, IPL must time any 2003 rate case so that it can be completed in time for IPL to file in 2004 to mitigate regulatory lag pursuant to the settlement. It is important to note that IPL is merely requesting authority to file an electric rate case in early 2003; IPL indicates no decision has yet been made that a 2003 filing will be necessary.

The Board will grant the request. While the Board does not generally like to see a new rate proceeding filed prior to the completion of a pending proceeding, it is necessary here to carry out the terms of the settlement. Granting the application encourages the building of utility-owned generation in Iowa, which was the Legislature's intent when passing section 476.53.

FINDING OF FACT

Based upon a thorough review of the whole record in these proceedings, the Board finds that the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

CONCLUSIONS OF LAW

The Board has jurisdiction of the parties and the subject matter in this proceeding, pursuant to Iowa Code chapter 476 (2001 Supp.).

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The settlement filed by Interstate Power and Light Company and the Consumer Advocate Division of the Department of Justice on August 29, 2002, is approved.

2. The application for authority pursuant to Iowa Code § 476.6(10) filed by Interstate Power and Light Company on August 29, 2002, is granted.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 17th day of September, 2002.